In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 123

JOHN P. DENISON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 118-131) are reported at 11 T. C. 686. The opinion of the Court of Appeals and dissenting opinion of Judge McAllister (R. 139-141) are reported at 180 F. 2d 938.

JURISDICTION

The judgment of the Court of Appeals was entered February 16, 1950. (R. 139-141.) A petition for rehearing was denied March 13, 1950. (R. 151.) The petition for a writ of certiorari was filed June 9, 1950. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the Tax Court's finding, affirmed by the Court of Appeals, that taxpayer's wife is not to be treated as his partner for federal income tax purposes, is supported by the facts.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) [As amended by Section 1 of the Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *.
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> * * * * *
>
> (26 U.S.C. 1946 ed., Sec. 22.)
>
> SEC. 181. PARTNERSHIP NOT TAXABLE.
>
> Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.
>
> (26 U.S.C. 1946 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

(26 U.S.C. 1946 ed., Sec. 182.)

STATEMENT

The facts, as found by the Tax Court (R. 119-126), may be summarized as follows:

Taxpayer, who had been employed as purchasing agent of Universal Cooler Corporation, a Detroit concern, was persuaded by his wife that he should resign and that they should go into the business of manufacturers' agent in Detroit. (R. 119.) Before taxpayer made his decision he satisfied himself that he could represent various concerns engaged in the production and sale of manufacturers' supplies, with which he had established contact as purchasing agent of Universal Cooler. He also made arrangements to sell the products to Whitman & Barnes Company and Detroit Harvester Company. These arrangements were made through Mrs. Denison's introducing taxpayer to the purchasing agents for these firms. Mrs. Denison's connection with the purchasing agents was

established through her acquaintance with their wives. (R. 119-120.)

The Denisons next made arrangements to share an office with a Mr. Schroeder, rent-free, in exchange for Mrs. Denison's doing clerical work and answering the phone for Mr. Schroeder. After these preliminary investigations taxpayer determined to undertake, with the assistance of his wife, the venture of manufacturers' agent. On July 31, 1940, their sole financial resources consisted of taxpayer's car, a mortgaged house, a few stocks owned by them separately, $428.19 deposited in their joint checking account, and taxpayer's salary of $375 per month from Universal Cooler Corporation. (R. 120.)

Upon the advice of friends Mr. and Mrs. Denison signed a partnership agreement on August 3, 1940, the partnership to be called "J. P. Denison Company" and to last for a ten-year period commencing September 2, 1940. The agreement provided for equal contributions of capital and sharing of profits and losses. The partnership activities were general in nature, consisting of the building, manufacture and sale of machinery and mechanical tools and the allied operations incidental to attaining these purposes. (R. 120-121.)

The Universal Cooler Corporation moved its plant to Marion, Ohio, in August, 1940, and taxpayer continued in its employ there until December 31, 1940, when he resigned, and henceforth devoted his full time to his own business. No sales

were made by J. P. Denison Company during 1940, while taxpayer was still employed by Universal, but taxpayer's activities were confined to making business connections, which he did when he returned home over the weekends. (R. 121-122.)

For the remainder of 1940, Mrs. Denison went to the office of J. P. Denison Company every day, where she performed general clerical work and answered the telephone for both Mr. Schroeder and taxpayer. During the week when taxpayer was working in Marion, Mrs. Denison was the sole representative of J. P. Denison Company in Detroit. A full-time maid was hired to take care of her home and children. (R. 121.)

No bank account was opened and no partnership return filed for 1940 because no sales were made during that year. (R. 121.)

An assumed name certificate showing Mr. Denison to be the sole owner and operator of the business using the name of J. P. Denison Company was filed by taxpayer on January 13, 1941. (R. 122.)

During the period January to September, 1941, J. P. Denison Company sold products on a straight commission basis and required little capital. Services performed by the husband, rather than capital, were responsible for the firm's income over this period. At all times taxpayer was in sole charge of the company's business activities. Mrs. Denison continued to work every day in the office as a clerk without compensation. (R. 122.)

On March 5, 1941, the Denisons transferred the balance in their joint checking account to an account in the name of the company on which either taxpayer or his wife could draw, but there is no evidence that Mrs. Denison used this privilege. The signature card for opening this new account stated that "the undersigned, John P. Denison," was the sole proprietor of the business, and the only signature in the space provided for the signature of all co-partners or sole proprietor was that of "John Denison." (R. 122.)

In August or September 1941, one of the companies for which the Denison Company was acting as manufacturers' agent—Bangor Products Company—threatened to discontinue sales because of the delay in payment on products it was selling to Detroit Harvester Company. The J. P. Denison Company agreed to purchase these supplies and in turn sell them to these manufacturers. For the purpose of the Bangor Products account the J. P. Denison Company adopted the name Bangor Products Company, but all of the income derived from such transactions was treated as part of the income of J. P. Denison Company. The assumed name certificate filed for Bangor Products Company stated that Mr. Denison was sole owner and operator of the business. (R. 122-123.)

The new arrangement required capital. Taxpayer contributed approximately $350 by selling his stocks at a loss. Mrs. Denison endorsed the certificates of stock owned by her and turned them

over to her husband who sold them at a loss for approximately $1,350 and deposited the proceeds in the firm's bank account. All of these securities were credited to taxpayer on the company journal. From this point forward the purchase and resale of Bangor products constituted the largest portion of the firm's business. (R. 123.)

Near the close of 1941 the Denison Company began the business of buying tools and dies and reselling them to large manufacturers. This enterprise required the use of substantial amounts of capital. (R. 123-124.)

The business records of J. P. Denison Company and Mr. Denison's income tax return for 1941 reflected a sole proprietorship in taxpayer, rather than a partnership between husband and wife. The firm's profit and loss account showed a balance of $18,795.19 on December 31, 1941, all of which amount was transferred to the personal account of taxpayer on that date. No drawing account or capital account for Mrs. Denison appeared on the company's books. No partnership tax return for J. P. Denison Company was filed. Taxpayer's income tax return, prepared by an accountant, reported the gross receipts from the company and included the firm's total net income in taxpayer's income. Mr. Denison took a deduction for the long-term capital losses on all the stock sold by him the previous fall to provide capital for the company. Mrs. Denison filed no tax return. (R. 124.)

During the war years 1942 and 1943 the volume of the Denison Company's business increased sharply. In August, 1943, the firm commenced manufacturing tools and dies itself and selling them to customers. This part of the business was conducted under the name of Detroit Machine Products Company but the income was included in that of J. P. Denison Company. In 1942 and 1943 the firm business consisted almost entirely of the purchase and resale, or the manufacture and sale of tools, jogs, dies and fixtures. Capital was a vital factor in these enterprises, although no inventory was ever used and the fixed assets were negligible. Detroit Harvester Company and Whitman & Barnes Company remained leading customers. (R. 124-125.)

Throughout 1942 and 1943 taxpayer remained in sole charge of all phases of J. P. Denison Company's business activities and his services continued to be vital. Mrs. Denison's clerical services were no longer performed on a regular basis. (R. 125.)

On December 31, 1942, an entry on the company journal, effective January 1, 1942, first reflected a partnership status. This entry transferred half of the capital from taxpayer's account to his wife. As a consequence the audit statement of J. P. Denison Company for 1942 and 1943 and of Detroit Machine Products Company for 1943 credited equal amounts of capital and income to taxpayer and his wife. (R. 125.)

Partnership tax returns were first filed for J. P. Denison Company in 1942 and a similar return was filed in 1943. On the back of both returns taxpayer stated that the partnership commenced on January 1, 1942. Net income of approximately $30,000 for 1942 and $52,000 for 1943 was reported as distributable one-half of taxpayer and one-half to his wife. (R. 125-126.)

Mrs. Denison first filed a tax return in 1942. She declared her occupation to be that of "Housewife." In both 1942 and 1943 she and her husband reported one-half each of the net income of the J. P. Denison Company. (R. 126.)

Only a negligible amount of the income of J. P. Denison Company was ever actually distributed to taxpayer or his wife; taxpayer allowed it to accumulate to finance the expanded operations of the firm. (R. 126.)

Before September, 1941, the income of J. P. Denison Company was due exclusively to personal services, but thereafter in 1941, 1942 and 1943 capital was a material income-producing factor. (R. 126.)

Mrs. Denison did not invest capital in the firm or contribute to its management. The services of measurable value which she performed were confined to 1940 and 1941. (R. 126.)

Neither taxpayer nor his wife intended to conduct J. P. Denison Company as a bona fide, working partnership at any time. (R. 126.)

ARGUMENT

This petition presents even less occasion for review by this Court than a number of other family partnership cases in which certiorari has recently been denied.[1] Although the Tax Court's decision here was rendered prior to the ruling in *Commissioner* v. *Culbertson,* 337 U. S. 733, the findings of fact and opinion of the Tax Court demonstrate that its holding is in complete conformity with the principles established in *Commissioner* v. *Tower,* 327 U. S. 280, and *Lusthaus* v. *Commissioner,* 327 U. S. 293, and explained in the *Culbertson* decision.

The Tax Court recognized that the ultimate question presented was, in the words of the *Culbertson* opinion, (p. 742), whether "the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise". In this connection the Tax Court phrased the issue as follows: (R. 126-127):

> * * * it is a question of fact whether Mr. and Mrs. Denison intended to operate J. P. Denison Company as a bona fide partnership or whether Mrs. Denison was a partner in form

[1] *Trapp* v. *United States,* 177 F. 2d 1 (C. A. 10th), certiorari denied, 339 U. S. 913; *Eisenberg* v. *Commissioner,* 161 F. 2d 506 (C.A. 3d), certiorari denied, 332 U. S. 767; *Kohl* v. *Commissioner,* 170 F. 2d 531 (C.A. 8th), certiorari denied, 337 U. S. 956, rehearing denied, 338 U. S. 839; *Fainblatt* v. *Commissioner,* 172 F. 2d 389 (C.A. 2d), certiorari denied, 337 U. S. 957, motion for leave to file petition for rehearing denied, 338 U. S. 841; *Moore* v. *Commissioner,* 170 F. 2d 191 (C.A. 4th), certiorari denied, 337 U. S. 956, motion for leave to file petition for rehearing denied, 338 U. S. 841.

> only. We must determine their intent by examining all the circumstances surrounding the partnership agreement of August 3, 1940, the terms of this agreement and the conduct of the Denisons subsequent to its execution.

As for the evidence, it is clear, as the court below held, that the Tax Court's conclusion is not "clearly erroneous". The trial court's findings of fact, which were in every respect supported by the evidence, were, *inter alia,* (R. 122-126), that "throughout 1942 and 1943 Mr. Denison's services continued to be vital in the successful rise of the company," but that "Mrs. Denison's clerical services were no longer performed on a regular basis" and "were no longer a measurable factor;" that throughout 1942 and 1943 taxpayer "remained in sole charge of all phases of J. P. Denison Company's business activities;" that the "business records of J. P. Denison Company and Mr. Denison's income tax return for 1941 reflected a sole proprietorship in petitioner rather than a partnership between husband and wife;" that "during the war years 1942 and 1943 the volume of J. P. Denison Company's business increased sharply;" that "on December 31, 1942, an entry on the company journal, effective January 1, 1942, first reflected a partnership status;" that "partnership tax returns were first filed * * * in 1942" and on the back of those returns taxpayer "stated that the partnership commenced on January 1, 1942;" that "Mrs. Denison first filed a tax return in 1942"

wherein "she declared her occupation to be that of 'House wife' "; that two assumed name certificates and the bank signature card stated that taxpayer "was the sole proprietor of the business;" that "Mrs. Denison did not invest capital in the firm or contribute to its management;" that "neither petitioner nor his wife intended to conduct J. P. Denison Company as a bona fide, working partnership at any time."

Taxpayer testified that even prior to the taxable years involved Mrs. Denison's services were merely of a general clerical nature, and that during 1942 and 1943 those services had decreased so that she gave no more than 20% of her time during the latter year to the company (R. 51).

As to the alleged contribution of capital by Mrs. Denison to the company from the proceeds of her stock (Br. 57), the Tax Court correctly held (R. 129) that:

> The manner in which the proceeds were treated by the parties furnishes a surer guide to the Denisons' intent than their self-serving testimony that she was making a capital contribution.

The fact that she turned the stock over to her husband at a time when the company needed money is entirely consistent with her having given the stock to him for use in his business; and, as the Tax Court pointed out (R. 129), the fact that on the company journal all the stock was credited to

him, and that he took the deduction for the capital loss arising from the sale of the stock, is consistent only with ownership of the securities by Mr. Denison and a capital contribution on his part. Most important is the fact that although the purported contribution occurred in 1941, there was absolutely nothing in the company's records to indicate the existence of a partnership until December 31, 1942, when an entry on the company journal, effective January 1, 1942, transferred half of the capital account from taxpayer's account to his wife. (R. 125.)

In short, the record falls far short of showing that "the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise." *Commissioner* v. *Culbertson,* 337 U. S. 733, 742.

The Court of Appeals considered all of the facts, in the light of the *Culbertson* decision, and concluded that the Tax Court was entirely correct in holding "that neither petitioner nor his wife intended to conduct a bona fide, working partnership." (R. 126, 139.)[2]

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[2] As for taxpayer's contention that this case is in conflict with the decision of this Court in *Edison Co.* v. *Labor Board,* 305 U. S. 197, the contention is devoid of merit. The *Edison Co.* case held only that the statute, in providing that findings shall be conclusive if supported by evidence, means supported by substantial evidence. While here the applicable principle of review is the so-called "clearly erroneous" principle, in view of the persuasive nature of the evidence, the determination of the Tax Court would be sustained, regardless of the scope of the appellate court's reviewing power.

The cases relied upon by the taxpayer are not controlling here since, as he concedes (Br. 37), "the validity of each family partnership turns on the factual background involved," and no conflict can be said to exist merely because different triers of fact have reached different conclusions as to the validity of different family partnership arrangements.

CONCLUSION

The determination of the Court of Appeals involves only the application of settled principles to the particular facts, and presents no conflict of decisions. The petition for certiorari should be denied.

Respectfully submitted,

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